

EARNINGS AND BALANCE SHEET CONSERVATISM IN MALAYSIA: THE EFFECT OF MALAYSIA'S CONVERGENCE TO INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

Marziana Madah Marzuki^{1*} and Effiezal Aswadi Abdul Wahab²

¹Faculty of Accountancy, Universiti Teknologi Mara, Bukit Ilmu,
18500 Machang, Kelantan, Malaysia

²School of Accounting, Curtin University of Technology, Kent St,
Bentley WA 6102, Australia

*Corresponding author: marziana@kelantan.uitm.edu.my

ABSTRACT

The objective of this paper is to examine the impact of International Financial Reporting Standards (IFRS) on both earnings and balance sheet conservatism in Malaysia. Earnings conservatism has been used extensively in common-law countries such as the United States (US) and the United Kingdom (UK), which are known to have good financial reporting quality. In contrast balance sheet conservatism is more evident in code-law countries such as Japan and France, where accounting practice is highly influenced by the institutional culture similar to Malaysia such as political connection and family-firms. Since Malaysia uses international accounting standards adopted from common-law countries, we hypothesise that earnings conservatism will increase whereas balance sheet conservatism will decrease after the incorporation of IFRS in the financial reporting environment. Consistent with the hypothesis, we find that earnings conservatism and balance sheet conservatism increase and decrease respectively after Malaysia's convergence to IFRS. The results indicate that Malaysia has successfully adopted IFRS from common-law countries as earning conservatism increase after IFRS convergence.

Keywords: Earnings conservatism, balance sheet conservatism, Malaysia, IFRS

Published date: 21 April 2017

To cite this article: Madah Marzuki, M. & Abdul Wahab, E. A. (2016). Earnings and balance sheet conservatism in Malaysia: The effect of Malaysia's convergence to International Financial Reporting Standards (IFRS). *Asian Academy of Management Journal of Accounting and Finance*, 12(2), 153–181. <https://doi.org/10.21315/aamjaf2016.12.2.7>

To link to this article: <https://doi.org/10.21315/aamjaf2016.12.2.7>

© Asian Academy of Management and Penerbit Universiti Sains Malaysia, 2016

INTRODUCTION

The issue of financial reporting quality has become more prominent due to recent corporate failures that occurred in developed countries, such as the United States of America, where rules and regulations are more stringent and rigid compared to other countries. The collapse of Enron and WorldCom have drawn the attention of regulators, practitioners, auditors and researchers, both in developed and developing countries, to the issue of financial reporting transparency. These cases have shattered the whole nation, particularly the companies' shareholders, as the financial reporting of the companies were 'decorated' with promising profits, lower debts and high revenues. In financial reporting, the issue of corporate transparency is more important as information that is accurate and relevant is needed by investors in their investment decision making and at the same time to ensure the security of their investments. Regulators are also demanding corporate transparency in order to exert more control on company operations and the behaviour of managers.

Levitt (1998) defines quality as financial reporting transparency that signifies the basis of any business.¹ He further states that success of capital markets is explicitly dependent on the accounting and disclosure system where high-quality accounting standards will produce financial statements that report events in real-time. High-quality financial reporting ensures no added reserves and deferral of losses, and actual volatility is not smoothed away to portray a false representation of steady and consistent growth. Following the definition of quality as proposed by Levitt (1998), conservatism is regarded as the best measure for financial reporting transparency as this concept requires a higher level of verification in distinguishing between the good and the bad news. In this concept bad news is recognised earlier than good news and therefore earnings reflect bad news more quickly than good news. This means bad news is identified sooner than good news, thus, earnings reflects bad news faster than good ones. Francis, Lafond, Olsson, and Schipper (2004) and Vichitsarawong, Eng and Meek (2010) use conservatism as a measure of financial reporting transparency since conservatism is regarded as a desirable attribute of accounting earnings that can be used in order to avoid unexpected economic downturn and corporate failure.

There are two types of conservatism: Earnings and balance sheet conservatism. Earnings conservatism is defined as the asymmetric response of earnings to economic gains and losses as such losses are recognised immediately in the current period, whereas profit will be reflected in the financial statement gradually over a number of years (Basu, 1997). Meanwhile, balance sheet conservatism is defined as the understatement of book values of net assets and overstatement of liabilities in the balance sheet with respect to market value of the firm (Feltham

& Ohlson, 1995). Both types of conservatism lead to understatement of assets or profit and overstatement of liabilities or losses. However, what makes these two differ is the time of recognition as earnings conservatism is applied when there is news or indication from the stock prices whereas balance sheet conservatism is persistently applied in the balance sheet when it is compared to market value of the firm without any basis or indication.

Due to the basis of recognition, earnings conservatism has been extensively used as a proxy for financial reporting quality compared to balance sheet conservatism and this type of conservatism has been tested on various applications such as litigation, contracting, corporate governance and other regulations. Most of the results provided by the previous studies (Ball, Kothari, & Robin, 2000; Ball, Robin, & Shuang Wu, 2003; Basu, 1997; Bushman & Piotroski, 2006) support that earnings conservatism play an important role in alleviating agency problems and limit the losses from poor investment decisions. In contrast, balance sheet conservatism has been criticised as it provides understatement of book value without any basis or indication and hence facilitates the creation of "cookie-jar reserves" which may lead to earnings management².

Investigating the effects of regulation such as IFRS on both types of conservatism is interesting as earnings conservatism is more apparent in common-law countries such as U.K which are known as having high financial reporting quality whereas balance sheet conservatism is more evident in code-law countries such as Germany and Japan where the main sources of financing are from a system of relationship-oriented capital, ownership structure which is more concentrated, less shareholder activism and a taxation policy that relies more on the lower value of assets (Black & White, 2003; Gassen, Fuelbier, & Sellhorn, 2006; Joos & Lang, 1994; Lara & Mora, 2004). Lara and Mora (2004) argue that in the so-called common-law-based countries such as UK, the degree of balance sheet conservatism will be less pronounced than in the so-called code-law-based countries. Higher financial reporting quality in common law country is recognised as timely loss recognition as compared to code law countries (Ball et al., 2003). The loss recognition is considered as more important as the nature of companies tend to disclose good news as compared to bad news. Malaysia is one of the countries that decided to adopt IFRS by the year 2012. Despite the adoption, Malaysia provides a unique institutional setting. Principally, Malaysia uses *International Accounting Standards* (IAS), adopted by common-law countries such as the US and UK which have been known as having high quality of financial reporting (Ball et al., 2003). Nevertheless, primarily, accounting practices in Malaysia are highly influenced by its institutional culture similar to the code-law countries' such as political connection and family firms (Ball et al., 2000, Muniandy & Ali,

2012). The CLSA (Credit Lyonnais Securities Asia) Asia Pacific Markets report on the overall of Malaysia's performance in Corporate Governance Watch 2007 reported that there is little confidence in the Malaysian market that independent directors are genuinely independent. Although public enforcement efforts have improved, the report blames the regulators for not having a reputation for treating companies and individuals equally. The CLSA committees make consensus that it is politics that hampers the ability of regulators to do their job properly (CLSA Asia Pacific Markets, 2007). The CLSA report in 2010 once again highlighted this issue as they pointed out that the main area of weaknesses in Malaysian corporate governance is on accountability and the number of independent audit committees. Their report highlight that Malaysia's financial reporting quality is significantly affected by culture (CLSA Asia Pacific Markets, 2010) as Malaysia's score for corporate governance culture dropped 1% from 33% in 2007 to 32% in 2010.³ When comparing the governance score between political and regulatory and CG culture of 11 capital markets in Asia, the gap between these two scores is greatest in Malaysia which shows that CG culture still poses a threat to the corporate governance practices here even though there is improvement in the enforcement and regulatory system.

Due to unique institutional setting of Malaysia, investigating the effects of regulation such as IFRS on both types of conservatism is appealing. In addition, evidence on the impact of IFRS in Malaysia is rather limited. Wan Ismail, Kamarudin, Van Zijl and Dunstan (2013) provide initial evidence on the effects of IFRS on earnings quality in Malaysia. They found that, based on a proxy for earnings management, IFRS adoption increases the earnings quality in Malaysia. We opted for a similar approach to Wan Ismail et al. (2013). However, instead of examining the effects on accruals quality, we investigate the effects of IFRS on both earnings and balance sheet conservatism. In addition to extending an outlook on earnings quality in Malaysia, our choice of measures of conservatism will provide a support on the role of institutional settings in Malaysia.

We offer the following motivations. First, to our humble knowledge, we initiate the first investigation on balance sheet conservatism in Malaysia. We view balance sheet conservatism as a complimentary tool on earnings conservatism and as proxies for earnings quality. Evidence on conservatism (either earnings or balance sheet) is limited in Malaysia. Mohamed Yunos, Ismail and Smith (2012) provide some evidence on the relationship of various ethnic groups and earnings conservatism and found mixed evidence. The use of a single type of conservatism (i.e. earnings conservatism) may not justify the insignificant findings between ethnicity and conservatism in their study. Therefore, an investigation on the effect

of IFRS on different types of conservatism may provide a different picture on Malaysia's institutional setting and its relationship with earnings quality.

We analyse earnings and balance sheet conservatism before and after IFRS. For earnings conservatism we used the model by Basu (1997) whereas for balance sheet conservatism we opted the model by Garcia-Lara and Mora (2004). This study is motivated by Malaysia's convergence to IFRS in 2006. Malaysia has announced its full convergence to IFRS on 1 August 2008 by 2012 but the effects of IFRS convergence with local standards is still largely unexplored.

This study differs from other studies on conservatism and IFRS in several ways. First, this study is conducted specifically on Malaysia's institutional settings which could provide better and compelling evidence. Recent studies conducted utilised multiple countries by comparing the effect of IFRS adoption in code and common law countries (Callao, García, Jarne, & Gadea, 2010; Lara, Torres, & Viera, 2008) or in developing countries which have different legal systems and culture from emerging countries like Malaysia (Callao, Jarne, & Láinez, 2007; Karampinis & Hevas, 2011; Piot, Janin, & Dumontier, 2011). Second, this study investigates the effects of IFRS convergence on both types of conservatism; earnings and balance sheet conservatism. The investigation of both types of conservatism will help us to understand the uniqueness of Malaysia's institutional setting and its relation to financial reporting quality.

Our results suggest that earnings conservatism is enhanced after IFRS. We also find that balance sheet conservatism is lower after the convergence. Therefore we provide strong evidence that IFRS is one of the main determinants of conservatism supporting the argument by Watts (2003a, 2003b).

INSTITUTIONAL BACKGROUND

IFRS Adoption in Malaysia

Before IFRS was issued by International Accounting Standards Board (IASB), the standards used were International Accounting Standards (IAS) issued by International Accounting Standards Committee (IASC) from 1973 to 2001. After 2001, IASB published IFRS and, therefore, any standard in IAS that are contradictory with IFRS, will definitely be superseded by IFRS and IAS are usually disregarded.

Malaysia's early adoption of a few IAS begins since 1978 until 1997. During this period, Malaysia Accounting Standards Board (MASB) standards are already in line with standards issued by IASB. However, the IASB standards are modified to suit the local environment, thus becoming national standards. The issuances made by the Malaysian Association of Certified Public Accountant (MACPA) together with the Malaysian Institute of Accountants (MIA) were not enforceable on companies. In 1997, Parliamentary Act established MASB and confers MASB standards as a legal standing for all firms. The standards issued by MASB became enforceable by virtue of Companies Act 1965 as well as other relevant acts for specialised industries like insurance.

In 2005, as support for the IFRS issued by IASB, MASB rename the MASB standards to Financial Reporting Standards (FRS) meant to make it in line with standards issued by IASB except for some minor modifications. In January 2006, all Malaysian firms are required to converge the local reporting standards with IFRS by preparing financial statements according to IFRS. Since this year, Malaysian IFRS standards have been identical to the respective IFRS and IAS. The difference lies in the standards that Malaysia has not adopted. With the convergence, modifications of the standards are made if necessary. Instead of adopting the whole standards as a required standard to prepare financial statements, Malaysia introduced two-tier financial reporting framework whereby the IFRS framework is made mandatory for non-private entities while the private entities can continue using the old MASB standards known as PERS (Private Entity Reporting Standards) framework. Figure 1 shows the milestones for Malaysia's convergence to IFRS.

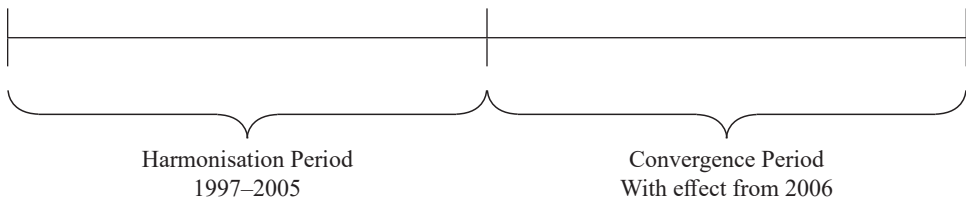


Figure 1. Milestones for Malaysia's convergence to IFRS

IFRS still provide various mechanisms which indirectly ensure the application of conditional conservatism. For example, recognition of probable liabilities and non-recognition of contingent asset in IAS 37, lower cost or net realisable value for inventories (IAS 2) and impairment of asset in IAS 36. Comparing IFRS with the local GAAP, IFRS introduced more stringent and systematic impairment testing rather than amortisation based on the judgement. The differences of financial reporting standards in the IAS and IFRS that would lead to more conservatism using IFRS are shown in Appendix.

Malaysia's Political Economy and Ownership Structure

Malaysia's political economy is highly influenced by family ownership and political connection (Claessens & Fan, 2002; Jaggi, Leung, & Gul, 2009). This type of political economy has enabled corporate entities in Malaysia to seek capital fund from "insiders" rather than from capital market. Faccio (2007) reports that connected firms enjoy easier access to debt financing from state-controlled banks, even though their situations do not justify additional credit. Johnson and Mitton (2003) found that politically connected public firms in Malaysia had significantly better returns even under the situation of capital control. Therefore, there is less demand of informative financial statements by the public. In addition, being politically connected facilitates firms to get private information and, hence, any information asymmetry between shareholders and managers are settled through "insider communication" rather than through "public disclosure". While compliance with approved accounting standards is mandatory, companies may send voluntary signals about their activities and performance using private information (Mohd Saleh, Che Abdul Rahman, & Hassan, 2009). This situation creates less incentive for the preparers of financial statement to enhance disclosure by adopting IAS.

The influence and dominance of family presence and ownership in Malaysia has been well documented (Claessens & Fan, 2002; Jaggi et al., 2009). According to statistics, which has been presented by South China Morning Post (SCMP), Malaysia has the second highest percentage of family ownership of listed companies in the region after Indonesia (Jaggi et al., 2009). Claessens, Djankov and Lang (2000) found that the presence of family dominance has enabled them to control firms and this represents a large percentage of stock market capitalisation in nine East Asian countries including Malaysia. This situation has led to Type II agency problem, which is the conflict between majority and minority shareholders in which minority shareholders have less power to voice out their dissatisfaction with a firm's poor governance.

Institutional background of Malaysia, which emphasises the Bumiputras privileges, has also leaved it hostile to ethnic Chinese Malaysians.⁴ In order to establish their position among the Malays, Chinese businesses have responded in several ways. Chinese Malaysians with mobile capital investments have move away from active politics, engaging in high-risk, short-term speculative ventures and diversifying overseas to strengthen the concession in Malaysia's political economy. Malaysia's richest man, Robert Kuok Hock Nien, for example, has diversified his interests across Asia without any political favouritism. Some of them, for example Vincent Tan Chee Yioun from property and gambling conglomerate Berjaya Group, seeks direct ties with a Malay political party through its official

Chinese party in the UMNO coalition, the Malaysian Chinese Association (MCA) (Pepinsky, 2008).⁵

Malaysia's convergence to IFRS is seen as a step forward to produce accounting earnings characteristics closer to common-law countries such as the U.K. It is seen as good effort by the regulators to enhance transparency and give awareness to public listed companies and stakeholders on the importance of faithful and truthful financial statements. Dato' Zainal Abidin Putih, the chairman of MASB, in one of his speech on Malaysia's full convergence to IFRS in 2012, commented that since Malaysia has included the provisions of the international standards into its local accounting standards beginning 1978 and these standards have also been used by more than a hundred countries worldwide, it is believed that IFRS will facilitate comparability and increase transparency (PricewaterhouseCoopers, 2009) and thus is expected to prevail over the code law countries' characteristics.

EMPIRICAL PREDICTIONS

The concept of conservatism historically has been one of the most influential accounting principles (Sterling, 1967) and has dominated other accounting principles such as historical cost and realisation concept for centuries (Basu, 1997). Various definitions of conservatism have been proposed by the accounting authority bodies such as IASB and FASB and these definitions have also led to debate on the applications of conservatism as a proxy for financial reporting quality.

In the Statement of Standard Accounting Practice No. 2 (SSAP2): "Disclosure of Accounting Policies" conservatism is described as understatement of assets or profits and overstatement of liabilities or losses (Accounting Standards Board, 1971). Nevertheless, the general authoritative definition to some extent does not properly discuss on what is the appropriate level of conservatism and how it is determined (Hellman, 2008). Hellman (2008) illustrates that previous researchers (such as Schmalenbach [1959] and Sillen and Vasthagen [1962]) are also unclear on how far conservatism should be applied. To some extent, they argue that conservatism can play its role to protect the stakeholders, whereas in other extent conservatism may lead to manipulation and distortion of information.

Earnings Conservatism

Basu (1997) proposes an operational definition of conservatism, which provides a clearer base of assets or profits and liabilities or losses valuation, compared to the theoretical definition provided by the authority bodies. Basu (1997) defines

conservatism as reflecting bad news more quickly than good news. He states that conservatism is applied when there is news by requiring higher degree of verification for recognising good news compared to bad news. Chi, Liu and Wang (2009) state that there are two important reporting features of earnings conservatism, which are asymmetric timeliness in recognition of gains versus losses and, a systematic understatement of net assets. The term "systematic" provides an explanation that the earnings conservatism based on valuation needs a formal indication on when to recognise and how much to recognise.

Balance Sheet Conservatism

Balance sheet conservatism is consistent with unconditional or ex-ante conservatism as this type of conservatism is not dependent on the news and it is recognised before or without receiving any news (Pae, Thornton, & Welker, 2005). Givoly and Hayn (2000) use market-to-book ratio as a proxy for the degree of balance sheet conservatism. This measurement is based on the balance-sheet-oriented definition of conservative accounting suggested by the theoretical framework developed by Feltham and Ohlson (1995). Feltham and Ohlson (1995) define balance sheet conservatism as "the existence of a persistent understatement of the book value figure with respect to market's valuation of the firm". The market-to-book ratio, that is greater than one, indicates conservative accounting and, other things being equal, an increase in the ratio over time suggests an increase in the degree of reporting balance sheet conservatism.

Conservatism and IFRS

Most of prior studies have documented positive effects of IFRS. There are evidence that IFRS can reduce analysts' absolute forecast error (Ashbaugh & Pincus, 2001), have more persistent and more conditionally conservative earnings (Gassen et al., 2006), can cause an increase in market liquidity (Daske, Hail, Leuz, & Verdi, 2008), and a decrease in earnings management (Barth, Landsman, & Lang, 2008; Zéghal, Chtourou, & Sellami, 2011) and an increase in stock price informativeness (Beuselinck, Joos, Khurana, & Meulen, 2009). There are also evidences that IFRS can enhance conservatism. Lara et al. (2008) show in their results that earnings conservatism is more pronounced in common-law-based developed economies and the voluntary use of IASB standards in Europe (prior to 2005) has significantly increased the measures of earnings conservatism in adopting firms.

Previous studies (e.g. Barth et al., 2008; Daske et al., 2008) offer three arguments on why the adoption of IFRS can yield significant capital market benefits. Firstly, its reporting promotes transparency and this improves the quality

of financial reporting since the standards are more capital-market-oriented and more comprehensive than local GAAP, particularly when involving disclosures. Secondly, this practice also lowers the amount of reporting discretion in relation to local GAAPs. Thirdly, IFRS reporting has been found to improve financial statement comparisons across firms. Additionally, according to Ewert and Wagenhofer (2005), the tightening accounting standards can reduce the level of earnings management and hence improve financial reporting quality.

IFRS emphasises on fair value principle which involves a process of asset or liability recognition, initial measurement at fair value, re-measurement (again, largely, at fair value) and de-recognition. Based on this principle, losses will be valued at market value, thus, increases conservatism among managers.⁶ Since the natural behaviour of humans is to be more inclined to disclose good news rather than bad news, recognition of losses is considered as more important in increasing transparency among managers.

Hellman (2008) proposes that the consistent understatement of assets characterised by the balance sheet approach is overcome in the IFRS as the new standards temporarily lower down the value of assets and will be reversed later due to change in accounting estimates. Hellman (2008) stresses that conservatism applied in IFRS can reduce the creation of hidden (off-balance) reserves or excessive provisions created by consistent undervaluation of asset in balance sheet conservatism.

It is believed that rules and regulations such as IFRS is one of the determinants of earnings conservatism that can induce firms to protect their shareholders and debt holders. Malaysia's convergence of local standards to IFRS is seen as a step forward by the regulators to enhance transparency and put awareness on public listed companies and the stakeholders on the importance of faithful and truthful of financial statements. Therefore, we hypothesise that:

H1: Earnings conservatism increases after IFRS convergence

Ball and Shivakumar (2005) state that there are three reasons earnings conservatism is preferable than balance sheet conservatism. First, the timely loss recognition of earnings conservatism provided by Basu's (1997) model provides an important role of conservatism in governance. Secondly, by understating the book value of assets, balance sheet conservatism reduces the opportunities of firms to account value in a conditionally conservative fashion. For example, if firms take into account balance sheet conservatism by immediate expensing assets, it eliminates their opportunity to impair the asset when the market value provides

evidence that the value has been reduced. Thirdly, balance sheet conservatism can reduce contracting efficiency as it introduces randomness in decisions based on financial information.

Due to these reasons, this type of conservatism has been subjected to criticisms and is associated with lower financial reporting quality. Ball and Shivakumar (2005) argue that conservatism "seems at best neutral if the bias of understatement is known". If the bias is unknown, then it may lead to inefficiency. Therefore, even though both of the definition of balance sheet and earnings conservatism is understood as lead to bias (higher verification of revenue compared to losses), at least the bias in earnings conservatism is known. Due to these arguments, we hypothesise that:

H2: Balance sheet conservatism decreases after IFRS convergence

Empirical research have been done by researchers (e.g. Pae et al., 2005; Beaver & Ryan, 2005; García-Lara & Mora, 2004; Givoly, Hayn, & Natarajan, 2007; Roychowdhury & Watts, 2006; Pope & Walker, 2003) to test the relationship between earnings and balance sheet conservatism and they support that there is a negative relationship between earnings and balance sheet conservatism as such balance sheet conservatism pre-empt earnings conservatism.

DATA AND RESEARCH METHODS

Sample Selection and Data Collection

Our initial sample consists of 857 firms from Bursa Malaysia listed firms over the period 2004-2009. Financial institutions, insurance and real estate companies are excluded due to different regulatory framework. PN4 companies, companies that change their financial year end and companies with missing data are also excluded from the sample yielding a final sample of 3274 observations for earnings conservatism and 4018 observations for balance sheet conservatism. The differences between the sample of earnings and balance sheet conservatism is mainly attributable to the need of one year observation of price adjusted on pre-sample period to calculate return and also to the fact that excludes all missing values for the price adjusted. The sample is divided into two periods which are pre-IRS (2004 and 2005) and post-IFRS (2006 till 2009). The year selection is based on effective date for preparing financial statements based on IFRS for all Malaysian firms which is on 1 January 2006.

Table 1
Data distribution of sample firms

Panel A: Earnings Conservatism	
Description	Number of observations
Initial sample	5142
(-) Financial institutions, insurance and real estate companies	(294)
(-) PN4 companies, companies that change financial year end and companies with missing data	(1501)
(-) Outliers	(73)
Final sample	3274
Panel B: Balance Sheet Conservatism	
Description	Number of observations
Initial sample	5142
(-) Financial institutions, insurance and real estate companies	(294)
(-) PN4 companies, companies that change financial year end and companies with missing data	(284)
(-) Outliers	(546)
Final sample	4018

Table 2
Description of variables

Panel A: Earnings Conservatism		
Variables	Symbol	Definition
Earnings/price (DV)	N	Net income before extraordinary items per share of firm <i>i</i> , deflated by beginning of period share price
Returns	R	Fiscal year continuously compounded return (log)
Negative returns	DR	Dummy variable that takes the value of one if return is negative, and zero otherwise
Panel B: Balance Sheet Conservatism		
Variables	Symbol	Definition
Share price	P	Share price at the balance sheet date
Net income	NI	Earnings per share
Book value	BV	Period-end book value of shareholders' equity per share (log)

Data are extracted from Compustat Global. The minimum data required for each firm-year observation are the current year's earnings, the previous fiscal year-end stock price, book value of assets and equity and returns data (Basu, 1997). Following Vichitsarawong et al. (2010) and Ball et al. (2003), accounting variables are deflated by the beginning of period price to control for heteroscedasticity. In addition, serial correlation of period SUR is reported for regressions to correct for heteroscedasticity and general correlation of observations within a cross-section. The 1st and 100th percentiles of each variable are excluded to reduce the effect of outliers. Finally, each firm-year observation with a missing value for any of the variables is excluded. Table 2 shows the definition of variables used in this study.

Model Specification

Earnings conservatism was tested using Basu's (1997) model specification. This model has been tested in Malaysia by Ball et al. (2003) and Vichitsarawong (2007). Basu (1997) uses reverse regression of annual earnings on contemporaneous returns to investigate the relationship between economic income, as measured by stock returns, and accounting income. The model is shown as follows:

$$N_{it} = \beta_0 + \beta_1 DR_{it} + \beta_2 R_{it} + \beta_3 R_{it} \times DR_{it} + \varepsilon_{it} \quad (1)$$

Where N_{it} is net income before extraordinary items per share of firm i , deflated by beginning of period share price; R_{it} fiscal year continuously compounded return; and DR_{it} is dummy variable, equalling one if R_{it} is negative, and zero otherwise. The earnings variable N_{it} is calculated, as $X_{it}/N_{it}P_{it-1}$ where X_{it} is net income before extraordinary items for firms i , N_{it} is the adjusted number of shares and P_{it-1} is the share price.

In this model, stock returns are the independent variable, while earnings are the dependent variable. The coefficient on stock returns β_2 measures the sensitivity of accounting income to positive stock returns (a proxy for economic gains). The coefficient β_3 is the main measurement for earnings conservatism which measures the incremental sensitivity of accounting income to the incorporation of bad news as measured by negative stock returns (a proxy for economic losses). The total sensitivity of accounting income to negative stock returns is measured by $(\beta_2 + \beta_3)$.

Previously, Givoly and Hayn (2000) used market-to-book ratio to examine the existence of balance sheet conservatism. Nevertheless, this measurement has been criticized as market-to-book ratio can be driven by many other factors (growth options, the possibility of monopoly rents and/or synergies, inflation, etc.). Consequently, Lara et al. (2004) investigate the effects of balance sheet

conservatism using a valuation framework provided by Ohlson (1995), which expresses price as a function of both earnings and book value of equity.

Ohlson model (1995) has been widely used in value-relevance study. Despite of that, the model has also been used to capture different properties of accounting such as conservatism. The model illustrates the effect of conservative accounting on the relation between equity value, accounting book value and future earnings (Lundholm, 2010).

This model has been utilised by Garcia-Lara et al. (2004) who investigates the effects of balance sheet conservatism using a valuation framework provided by Feltham and Ohlson (1995), which expresses price as a function of both earnings and book value of equity:

$$P_{it} = \alpha + \beta_1 NI_{it} + \beta_2 BV_{it} + \varepsilon_{it} \quad (2)$$

Where P_{it} is the share price at the balance sheet date, NI_{it} is the earnings after extraordinary items per share, BV_{it} is the period-end book value of shareholders' equity per share. In the particular model above, the intercept of the undeflated regression of price on earnings and book value is significantly larger, while the book value coefficient is significantly positive if the balance sheet conservatism exists and practiced in Malaysia. The coefficient B_2 is the main measurement for balance sheet conservatism.

In order to test the relationship between the adoption of IFRS and conservatism, both of the conservatism models are employed using dummy year variable for period pre (year 2004 and 2005) and post of IFRS (2006 till 2009).

$$N_{it} = \beta_0 + \beta_1 DR_{it} + \beta_2 R_{it} + \beta_3 R_{it} \times DR_{it} + \beta_4 D_IFRS + \beta_5 D_IFRS \times DR_{it} + \beta_6 D_IFRS \times R_{it} + \beta_7 D_IFRS_{it} \times R_{it} \times DR_{it} + \varepsilon \quad (3)$$

$$P_t = \alpha + \beta_1 NI_{it} + \beta_2 BV_{it} + \beta_3 D_IFRS_{it} + \beta_4 NI_{it} * D_IFRS_{it} + \beta_5 BV_{it} * D_IFRS_{it} + \varepsilon \quad (4)$$

where all variables as described above, D_IFRS_{it} is dummy variable which takes the value of 1 for the period after IFRS and 0 otherwise.

In model (3), dummy variables DR_{it} capture the intercept and slope effects for the negative return sample. Our focus variable is the coefficient β_7 which measures the relationship between the level of asymmetric timeliness

of conservatism and IFRS. It is expected that the coefficient to be positive and significant, showing that earnings conservatism is increased after the adoption of IFRS.

Coefficient β_2 measures the responsiveness of earnings to good news before the IFRS adoption, while the sum of $\beta_2 + \beta_6$ is measuring the responsiveness of earnings to good news after the IFRS adoption. A positive significant coefficient β_6 implies incremental responsiveness of earnings to good news after IFRS adoption. We offer no prediction for the intercept and incremental intercept coefficients β_0 , $\beta_1 DR_{it}$, $\beta_4 D_IFRS$ and $\beta_5 D_IFRS \times DR_{it}$ in measuring earnings conservatism.

In model (4), the relationship between balance sheet conservatism is determined by the coefficient β_5 which is the coefficient of the interaction between book value and the dummy year of IFRS. It is expected that the coefficient will be significantly negative, leading to the positive effect of IFRS as it leads to a decrease in the understatement of assets relative to market's valuation.

RESULTS

Descriptive Statistics

Table 3 reports descriptive statistics for all the variables within the periods. For earnings conservatism presented in Panel A of Table 3, the mean (median) value for the dependent variable, which is earnings, and independent variable which is return are 4.427 (0.000) and 1.174 (0.990) respectively. The mean value shows that throughout the period earnings are higher than return which indicates that overall the sample do not shows earnings conservatism. Nevertheless, in term of median, earnings are lower than return which indicates the existence of earnings conservatism. Standard deviation for earnings are also far larger than the standard deviation of return which indicates that throughout the period earnings is not really a function of return. For balance sheet conservatism tabulated in Panel B of Table 3, the mean (median) for book value of shares (*BV*) is 0.808 (1.000), which is slightly lower than share price (*P*), which shows a mean of 1.742 (0.910). The result for mean indicates that balance sheet exist among the firms in the sample as the book value is lower than the share price. Nevertheless, the result for median indicates that book value is slightly higher than the share price which indicates that firms are not conservative.

Table 3
Descriptive statistics

Panel A: Earnings Conservatism					
	Mean	Median	Maximum	Minimum	SD
N	4.427	0.000	152.516	-73.638	11.895
R	1.174	0.990	14.444	0.137	1.129
R (log)	-0.064	-0.010	2.670	-1.987	0.639
DR	0.506	1.000	1.000	0.000	0.500
Panel B: Balance Sheet Conservatism					
	Mean	Median	Maximum	Minimum	SD
P	1.742	0.910	51.250	0.025	3.015
NI	0.182	0.111	15.406	-3.646	0.468
BV	0.808	1.000	1.000	0.080	0.291
BV (log)	-0.332	0.000	0.000	-2.526	0.585

Note: SD = Standard Deviation

Univariate

We run univariate analysis to test the effect of IFRS on both types of conservatism. Table 4 presents differences in the mean and median values of our measures of measures of conservatism for the periods before and after IFRS. The table shows a significant improvement in some of conservatism variables. The average of return *R* has significantly increased from 0.981 to 1.239 after IFRS. Nevertheless, the value of earnings is not significantly difference from pre to post IFRS. The result indicates that even though return is significantly increasing, the value of earnings has no significant difference. This result indicates early evidence that IFRS has some effect on earnings conservatism. The average of share price *P* decreased from 1.895 to 1.691 whereas the average of net income *NI* shows a slight decrease from 0.205 to 0.175 after IFRS. The average of book value of shareholder's equity per share also decreases after IFRS from 0.879 to 0.784. The average of share price *P* decreased from 1.895 to 1.691 and it is only significant using Mann-Whitney test. The average book value of shareholder's equity per share (*BV*) show slight decreases after IFRS which is from 0.879 to 0.784 respectively. As presented in the table, the mean values for the share price are greater than the values for book value of shareholders' equity per share. This provides evidence of the existence of balance sheet conservatism in this country throughout the sample period. The decrease in value is even more after IFRS, providing more evidence that balance sheet conservatism is decreasing after IFRS.

Table 4

Univariate analysis of differences of earnings and balance sheet conservatism in the pre- and post IFRS

Panel A: Earnings Conservatism								
	Pre IFRS ($n = 943$)			Post IFRS ($n = 2331$)			p -value	
	Mean	Median	SD	Mean	Median	SD	t -test	Mann-Whitney
N	4.379	0.000	11.861	4.444	0.000	11.910	0.815	0.690
R	0.981	0.754	1.261	1.239	1.033	1.073	0.000	0.000
R (log)	-0.307	-0.282	0.679	0.018	0.033	0.603	0.000	0.000
DR	0.733	1.000	0.443	0.430	0.000	0.495	(0.000)	(0.000)
Panel B: Balance Sheet Conservatism								
	Pre IFRS ($n = 1976$)			Post IFRS ($n = 2042$)				
	Mean	Median	SD	Mean	Median	SD	t -test	Mann-Whitney
P	1.895	1.000	3.486	1.691	0.890	2.838	0.105	0.003
NI	0.205	0.119	0.676	0.175	0.108	0.373	0.107	0.074
BV	0.879	1.000	0.241	0.784	1.000	0.302	0.000	0.000
BV (log)	-0.201	0.000	0.463	-0.376	0.000	0.614	0.000	0.000

Note: Significant p -values are in bolds. The figures in parentheses () denote Chi-square statistics.

Multivariate⁷

In order to test more strongly on the role of IFRS on conservatism, we run multivariate analysis. Table 5 reports the regression results for earnings conservatism. The intercept is significantly positive throughout the models as predicted by Basu (1997). We present model 1 till 6 to show one by one the effect of earnings conservatism measured by the interaction of $DR * R$. We start with the basic model of Basu's (1997). The interaction of $DR * R$ which is earnings conservatism is significantly negative at 1%. The result remains negative throughout the model 1 till model 6 which indicates that overall the firms in the sample are not earnings conservative. Nevertheless, after we interact earnings conservatism with IFRS ($D_IFRS * DR * R$), the results show that earnings conservatism increases after IFRS and it is significant at 1% level. The result for R is significantly positive indicating that earning is more responsive to good news before IFRS adoption. Nevertheless, the positive interaction between $D_IFRS * R$ is significantly negative providing evidence that earnings are less responsiveness to good news after IFRS adoption.

The results indicate that the adoption of IFRS from common-law countries such as UK brings positive effect to the financial reporting quality in Malaysia. The result is consistent with Garcia-Lara et al. (2008) who found that the effects of IFRS

on earnings conservatism is more pronounced in common-law countries compared to code law countries. The results also support previous research (Barth et al., 2008; Daske et al., 2008) which argue that IFRS reporting increases transparency, reduces the amount of reporting discretion and improves comparisons across firms.

Table 5
Earnings conservatism and IFRS

Regressions	1	2	3	4	5	6
Intercept	2.884 1.988**	3.215 2.220**	3.655 2.450**	5.346 3.355***	4.181 2.581***	2.887 1.727*
DR	-0.319 -0.540	-0.835 -1.356	-0.484 -0.814	-2.870 -2.889***	-0.450 -0.372	0.010 0.009
R	5.491 7.763***	5.355 7.529***	5.449 7.699***	5.353 7.561***	7.985 7.859***	10.770 7.990***
DR*R	-4.107 -4.188***	-3.425 -3.380***	-3.950 -4.018***	-3.965 -4.037***	-4.589 -4.637***	-8.792 -5.292***
D_IFRS			-0.909 -1.939*	-2.841 -3.478***	-1.322 -1.423	0.286 0.266
D_IFRS*DR				2.907 2.962***	-0.455 -0.326	-0.745 -0.534
D_IFRS*R					-3.357 -3.484***	-6.918 -4.417***
D_IFRS*DR*R						5.955 2.938***
Period dummies	No	Yes	No	No	No	No
Industry dummies	Yes	Yes	Yes	Yes	Yes	Yes
Adjusted R ²	0.042	0.045	0.043	0.045	0.048	0.050
F-statistic	12.111	9.499	11.506	11.297	11.292	11.128
Observations	3274	3274	3274	3274	3274	3274
Cross-sections	772	772	772	772	772	772

Note: N = net income before extraordinary items per share of firm i, deflated by beginning of period share price; R = fiscal year continuously compounded return; DR = dummy variable, equalling one if R is negative, and '0' otherwise; D_IFRS = dummy variable which takes the value of 1 for period after IFRS and '0' otherwise.
*, ** and ***denote significance at the 10%, 5% and 1% level respectively.

Joos (2008) explains that IFRS differs from a country's individual accounting principles in terms of measurement and disclosure of accounting standards. IFRS emphasises on the fair value principle which involves a process of asset or liability recognition, initial measurement at fair value, re-measurement (again, largely, at fair value) and de-recognition. Based on this principle, losses

will be valued at market value and hence increase conservatism among managers. In terms of disclosure, IFRS emphasizes on detailed footnote disclosures. It sheds light on off-balance sheet information such as pension assets and liabilities and relevant business information such as segment information, litigation, share-based compensation, related-party transactions.

Table 6 reports the result of for the relationship between balance sheet conservatism and IFRS. The intercept is significantly positive throughout the models. Consistent with earnings conservatism model in Table 5, we present model 1 till 6 to show one by one the effect of balance sheet conservatism measured by the book value coefficient. Model 1 in Table 6 indicates the basic model of balance sheet conservatism. The book value coefficient is significantly positive throughout the model indicating the existence of balance sheet conservatism among the firms in the sample. The result indicates that understatements of assets

Table 6
Balance sheet conservatism and IFRS

Regressions	1	2	3	4	5
Intercept	0.983 5.754***	0.991 5.788***	0.997 5.788***	1.022 5.907***	1.045 6.031***
NI	2.143 26.198***	2.132 26.011***	2.142 26.196***	1.959 15.479***	1.960 15.504***
BV	0.236 2.827***	0.218 2.580***	0.233 2.774***	0.233 2.779***	0.405 3.244***
D_IFRS			-0.021 -0.649	-0.056 -1.531	-0.091 -2.262**
NI*D_IFRS				0.264 2.000**	0.262 1.988**
BV*D_IFRS					-0.236 -1.977**
Period fixed	No	Yes	No	No	No
Industry dummies	Yes	Yes	Yes	Yes	Yes
Adjusted R ²	0.259	0.275	0.259	0.259	0.260
F-statistic	118.027	90.767	108.960	101.533	95.077
Observations	4018	4018	4018	4018	4018
Cross sections	754	754	754	754	754

Note: P = share price at the balance sheet date; NI = earnings after extraordinary items per share; BV = period-end book value of shareholders' equity per share; D_IFRS = dummy variable which takes the value of 1 for period after IFRS and '0' otherwise.

*, ** and *** denote significance at the 10%, 5% and 1% level respectively

relative to market's valuation is still practised in Malaysia throughout the period. Nevertheless, the coefficient of net income is also consistently positive throughout the model indicating that earnings remain persist. The result indicates that both types of conservatism exist among the firms in the sample. Nevertheless when we interact the book value coefficient with IFRS ($BV*D_IFRS$), the result indicates that balance sheet conservatism decrease after IFRS and it is significant at 5% level. Supporting H_2 , the results indicate that the consistent understatement of assets characterised by the balance sheet approach is overcome in the IFRS as the new standards temporarily lower down the value of assets and will be reversed later due to changes in accounting estimates (Hellman, 2008). The negative relationship between balance conservatism and IFRS has been a sign that Malaysia has successfully adopted IFRS from common-law countries model even though their institutional structures can still be characterized as a variant of the code law model (Ball et al., 2003). Malaysia is one of the East Asian countries that has strong common-law influence especially in terms of its accounting standards as this country has adopted accounting standards from early British colonial influence to the more recent influence of IFRS.

Clarkson, Hanna, Richardson and Thompson (2011) state that the valuation role of earnings is more pronounced in shareholder oriented financial reporting compared to stakeholder-based. Ball et al. (2000) and Soderstrom and Sun (2007) emphasise that legal systems either code or common law countries, play an important role in influencing accounting standards. This is because, in common law countries, accounting standards are set by private sector bodies and, therefore, the purpose of standard setting is to satisfy the informational needs of investors. Meanwhile, in code law countries, standards are influenced by governments and other important stakeholders. Therefore, the role of accounting is to divide the interest between those parties. Bae, Tan and Welker (2008) report that there is greater divergence between a country's individual accounting principle and IFRS in code and common law legal system.

Sensitivity Analysis

Earnings conservatism

Because many other studies have criticised Basu's (1997) measure as having econometric biases (e.g., Dietrich, Muller, & Riedl, 2007; Patatoukas & Thomas, 2011), we measure conditional conservatism beyond Khan and Watts' (2009) modified conservatism measure based on Basu's (1997) work to ensure the robustness of our findings. The measure we use is based on the Ball and Shivakumar

(2005) accruals-based loss recognition model. We modify this measure using the methodology that Khan and Watts (2009) adopted to estimate a firm-year measure of conservatism:

$$ACC_{it} = \beta_0 + \beta_{1it}DC_{it} + \beta_{2it}CFO_{it} + \beta_{3it}DC_{it}*CFO_{it} + \varepsilon_{it} \quad (5)$$

where ACC_{it} is the total accruals in year t , deflated by the year $t-1$ market value of equity; CFO_{it} is the cash flow from operations in year t , deflated by the year $t-1$ market value of equity and DC_{it} is a dummy variable that is equal to 1 if CFO_{it} is negative and is 0 otherwise. The coefficient of the interaction term between DC and CFO (β_3) measures the conditional conservatism. If economic losses are recognised in a more timely manner than gains, then β_3 will be greater than 0.

Table 7
Earnings conservatism and IFRS (Ball & Shivakumar, 2005)

Regressions	Coefficient (basic model)	Coefficient (IFRS-integrated model)
Intercept	0.000 (0.032)	0.003 (0.192)
CFO	-0.363*** (-11.374)	-0.326*** (-6.730)
DCFO	0.012 (2.267)	0.007 (0.909)
CFO*DCFO	-0.516*** (-6.402)	-0.763*** (-6.360)
D_IFRS		-0.004 (-0.772)
D_IFRS*CFO		-0.058 (-1.020)
D_IFRS*DCFO		0.009 (0.821)
D_IFRS*CFO*DCFO		0.404*** (2.647)
Period fixed dummies	Yes	No
Industry dummies	Yes	Yes
Adjusted R-squared	0.196	0.196
F-statistic	54.208***	53.968***

Note: ACC_{it} = total accruals in year t , deflated by the year $t-1$ market value of equity; CFO_{it} = cash flow from operations in year t , deflated by the year $t-1$ market value of equity; DC_{it} = dummy variable that is equal to 1 if CFO_{it} is negative and is 0 otherwise.

*, ** and *** denote significance at the 10%, 5% and 1% level respectively.

The result using Khan and Watts (2009) adopted measure of earnings conservatism in Table 7 is consistent with Basu's (1997) model. The interaction DC and CFO is significantly negative which indicates that firms in the sample are not conditionally conservative. Nevertheless, when we interact the conservatism with IFRS, the result is significantly positive indicating that IFRS enhance earnings conservatism.

Table 8
Balance sheet conservatism and IFRS (Using MTB)

Regressions	Coefficient (basic model)	Coefficient (IFRS-integrated model)
Intercept	0.995*** 2.898	1.070*** 3.038
NI	2.292*** 21.936	2.281*** 12.933
MTB	0.133*** 31.060	0.144*** 20.365
D_IFRS		-0.092 -1.020
NI*D_IFRS		0.020 0.102
MTB*D_IFRS		-0.020*** -2.596
Period fixed dummies	Yes	No
Industry dummies	Yes	Yes
Adjusted R-squared	0.495	0.494
F-statistic	263.660***	298.153***

Note: P = share price at the balance sheet date; NI = earnings after extraordinary items per share; MTB = market-to-book ratio; D_IFRS = dummy variable which takes the value of 1 for period after IFRS and '0' otherwise.

*, ** and *** denote significance at the 10%, 5% and 1% level respectively.

Previously, Givoly and Hayn (2000) used market-to-book ratio to examine the existence of balance sheet conservatism. Nevertheless, this measurement has been criticised as market-to-book ratio can be driven by many other factors (growth options, the possibility of monopoly rents and/or synergies, inflation, etc.). Despite of the criticism, using market-to-book ratio (MTB) as a proxy for the degree of balance sheet conservatism is sensible, though it is still subject to argument. Therefore we provide the result for balance sheet conservatism using MTB in Table 8 as a measure of balance sheet conservatism. Firms are conservative when MTB is larger as firms understate the book value in relevant to market value. The

result produced in Table 8 is same with the previous one and in fact, it is more significantly negative which indicates that balance sheet conservatism decrease after IFRS.

CONCLUSION

Balance sheet conservatism has been used extensively in prior research parallel to earnings conservatism as one of the proxy for financial reporting quality due to its informational and behavioural aspects. Nevertheless this type of conservatism is more evident in code law country such as Germany and Japan where the main sources of financing are from system of relationship oriented capital, ownership structure which is more concentrated, less shareholder activism and taxation policy which relies more on the lower value of assets. In contrast, earnings conservatism is more apparent in common law countries where investors' protection is very high.

This study finds strong evidence that earnings conservatism is enhanced after IFRS, whereas balance sheet conservatism is reduced after the IFRS convergence. Therefore we provide strong evidence that regulation is one of the main determinants of conservatism supporting the argument by Watts (2003a, 2003b). The results indicate that Malaysia has successfully adopted IFRS from common-law countries models even though their institutional structures are still can be characterised as a variant of the code law model resulting in a decrease in balance sheet conservatism. The results, therefore, provide a motivation for the regulators in this country on the importance of regulation enforcement. It provides an empirical evidence that the role of regulators are very important to always review our accounting and corporate governance system in order to ensure that we can provide a safe and comfortable market to the investors.

NOTES

1. Arthur Levitt is the former Securities Exchange Commissions (SEC) in the US.
2. Cookie jar reserves are an accounting practice in which a company uses generous reserves from good years against losses that might be incurred in bad years.
3. CLSA (Credit Lyonnais Securities Asia) is a brokerage and investment groups focused on institutional brokerage, investment banking and asset management for corporate and institutional clients around the world.
4. In Article 153 in the Federal Constitution of Malaysia, Bumiputras is defined as "Malay" and "aborigine", "natives" of Sarawak and "natives" of Sabah.
5. Vincent Tan Chee Yioun is also one of the richest men in Malaysia.

6. Fair value principle is defined as "the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction" (Riahi-Belkoui, 2004).
7. Consistent with extant literature on conservatism, a number of interaction terms are used in this study. These interaction terms could give rise to potential multicollinearity issues. In some cases, the variance inflation factors are found to be higher than the preferred threshold of 10.

REFERENCES

- Accounting Standards Board. (1971). *Statement of standard accounting practice no. 2 (SSAP2): Disclosure of accounting policies*. UK: Institute of Chartered Accountant.
- Ashbaugh, H., & Pincus, M. (2001). Domestic accounting standards, international accounting standards, and the predictability of earnings. *Journal of Accounting Research* 39(3), 417–434. <https://doi.org/10.1111/1475-679X.00020>
- Bae, K. H., Tan, H., & Welker, M. (2008). International GAAP differences: The impact on foreign analysts. *The Accounting Review*, 83(3), 593–628.
- Ball, R., Kothari, S. P., & Robin, A. (2000). The effect of international institutional factors on properties of accounting earnings. *Journal of Accounting and Economics*, 29(1), 1–51. [https://doi.org/10.1016/S0165-4101\(00\)00012-4](https://doi.org/10.1016/S0165-4101(00)00012-4)
- Ball, R., Robin, A., & Shuang Wu, J. (2003). Incentives versus standards: Properties of accounting income on four east Asian countries. *Journal of Accounting and Economics*, 36(1–3), 235–270. <https://doi.org/10.1016/j.jacceco.2003.10.003>
- Ball, R., & Shivakumar, L. (2005). Earnings quality in UK private firms: Comparative loss recognition timeliness. *Journal of Accounting and Economics*, 39(1), 83–128. <https://doi.org/10.1016/j.jacceco.2004.04.001>
- Barth, M. E., Landsman, W. R., & Lang, M. H. (2008). International accounting standards and accounting quality. *Journal of Accounting Research*, 46(3), 467–498. <https://doi.org/10.1111/j.1475-679X.2008.00287.x>
- Basu, S. (1997). The conservatism principle and the asymmetric timeliness of earnings. *Journal of Accounting and Economics*, 24(1), 3–37.
- Beaver, W. H., & Ryan, S. G. (2000). Biases and lags in book value and their effects on the ability of the book-to-market ratio to predict book return on equity. *Journal of Accounting Research*, 38(1), 127–148. <https://doi.org/10.2307/2672925>
- Beuselinck, C., Joos, P., Khurana, I. K., & Meulen, S. V. D. (2009). *Mandatory IFRS reporting and stock price informativeness*. Working paper, Tilburg University.
- Black, E. L., & White, J. J. (2003). An international comparison of income statement and balance sheet information: Germany, Japan and the US. *European Accounting Review*, 12(1), 29–46. <https://doi.org/10.1080/0963818022000001127>
- Bushman, R. M., & Piotroski, J. D. (2006). Financial reporting incentives for conservative accounting: The influence of legal and political institutions. *Journal of Accounting and Economics*, 42(1–2), 107–148. <https://doi.org/10.1016/j.jacceco.2005.10.005>

- Callao, S., García, C. F., Jarne, J. I. J., & Gadea, J. A. L. (2010). IFRS adoption in Spain and the United Kingdom: Effects on accounting numbers and relevance. *Advances in Accounting, incorporating Advances in International Accounting*, 26(2), 304–313.
- Callao, S., Jarne, J. I., & Láinez, J. A. (2007). Adoption of IFRS in Spain: Effect on the comparability and relevance of financial reporting. *Journal of International Accounting, Auditing and Taxation*, 16(2), 148–178. <https://doi.org/10.1016/j.intaccudtax.2007.06.002>
- Chi, W., Liu, C., & Wang, T. (2009). What affects accounting conservatism: A corporate governance perspective. *Journal of Contemporary Accounting and Economics*, 5(1), 47–59. <https://doi.org/10.1016/j.jcae.2009.06.001>
- Claessens, S., Djankov, S., & Lang, L. (2000). Separation of ownership from control of East Asian firms. *Journal of Financial Economics*, 58, 81–112.
- Claessens, S., & Fan, J. P. H. (2002). Corporate governance in Asia: A survey. *International Review of Finance*, 3(2), 71–103. <https://doi.org/10.1111/1468-2443.00034>
- Clarkson, P., Hanna, J. D., Richardson, G. D., & Thompson, R. (2011). The impact of IFRS adoption on the value relevance of book value and earnings. *Journal of Contemporary Accounting & Economics*, 7(1), 1–17.
- Credit Lyonnais Securities Asia (CLSA) Asia Pacific Markets (2007). CG watch 2007: Corporate governance in Asia. Retrieved from https://www.clsa.com/assets/files/reports/CLSA_ACGA_CGWatch2007_Extract-2.pdf
- CLSA Asia Pacific Markets (2010). *CG watch 2010: Corporate governance in Asia*. Retrieved from <https://www.clsa.com/assets/files/reports/CLSA-CG-Watch-2010.pdf>
- Daske, H., Hail, L., Leuz, C., & Verdi, R. (2008). Mandatory IFRS reporting around the world: Early evidence on the economic consequences. *Journal of Accounting Research*, 46(5), 1085–1142. <https://doi.org/10.1111/j.1475-679x.2008.00306.x>
- Dietrich, J. R., Muller, K. A., & Riedl, E. J. (2007). Asymmetric timeliness tests of accounting conservatism. *Review of Accounting Studies*, 12(1), 95–124.
- Ewert, R., & Wagenhofer, A. (2005). Economic effects of tightening accounting standards to restrict earnings management. *The Accounting Review*, 80(4), 1101–1124. <https://doi.org/10.2308/accr.2005.80.4.1101>
- Faccio, M. (2007). *The characteristics of politically connected firms*. Purdue CIBER working paper no. 51, Purdue University. Retrieved from <http://docs.lib.purdue.edu/ciberwp/51>
- Feltham, G. A., & Ohlson, J. A. (1995). Valuation and clean surplus accounting for operating and financial activities. *Contemporary Accounting Research*, 11(2), 689–731. <https://doi.org/10.1111/j.1911-3846.1995.tb00462.x>
- Francis, J., Lafond, R., Olsson, P. M., & Schipper, K. (2004). Cost of equity and earnings attributes. *The Accounting Review*, 79(4), 967–1010.
- Gassen, J., Fuelbier, R. U., & Sellhorn, T. (2006). International differences in conditional conservatism: The role of unconditional conservatism and income smoothing. *European Accounting Review*, 15(4), 527–564. <https://doi.org/10.1080/09638180601102107>

- Givoly, D., & Hayn, C. (2000). The changing time series properties of earnings, cash flows and accruals: Has financial reporting become more conservative. *Journal of Accounting and Economics*, 29(3), 287–320. [https://doi.org/10.1016/S0165-4101\(00\)00024-0](https://doi.org/10.1016/S0165-4101(00)00024-0)
- Givoly, D., Hayn, C., & Natarajan, A. (2007). Measuring reporting conservatism. *The Accounting Review*, 82(1), 65–106. <https://doi.org/10.2308/accr.2007.82.1.65>
- Hellman, N. (2008). Accounting conservatism under IFRS. *Accounting in Europe*, 5(2), 71–100. <https://doi.org/10.1080/17449480802510492>
- Jaggi, B., Leung, S., & Gul, F. (2009). Family control, board independence and earnings management: Evidence based on Hong Kong firms. *Journal of Accounting Public Policy*, 28, 281–300.
- Johnson, S., & Mitton, T. (2003). Cronyism and capital controls: Evidence from Malaysia. *Journal of Financial Economics*, 67(2), 351–382. [https://doi.org/10.1016/S0304-405X\(02\)00255-6](https://doi.org/10.1016/S0304-405X(02)00255-6)
- Joos, P. (2008). Is IFRS bringing higher reporting quality to the table? *Tijdschrift voor Financial Executives*, 12, 18–24.
- Joos, P., & Lang, M. (1994). The effects of accounting diversity: Evidence from the European Union. *Journal of Accounting Research*, 32(Suppl.), 141–168. <https://doi.org/10.2307/2491444>
- Karampinis, N. I., & Hevas, D. L. (2011). Mandating IFRS in an unfavorable environment: The Greek experience. *The International Journal of Accounting*, 46(3), 304–332. <https://doi.org/10.1016/j.intacc.2011.07.001>
- Khan, M., & Watts, R. L. (2009). Estimation and empirical properties of a firm-year measure of accounting conservatism. *Journal of Accounting and Economics*, 48(2–3), 132–150. <https://doi.org/10.1016/j.jacceco.2009.08.002>
- Lara, J. M. G., & Mora, A. (2004). Balance sheet versus earnings conservatism in Europe. *European Accounting Review*, 13(2), 261–292. <https://doi.org/10.1080/0963818042000203347>
- Lara, J. M. G., Torres, J. A. R., & Veira, P. J. V. (2008). Conservatism of earnings reported under international accounting standards: A comparative study. *Revista Espanola de Financiacion Contabilidad*, 37(138), 197–210. <https://doi.org/10.1080/02102412.2008.10779642>
- Levitt, A. (1998). *The numbers game*. New York: Presentation at the New York University Center for Law and Business.
- Mohamed Yunos, R., Ismail, Z., & Smith, M. (2012). Ethnicity and accounting conservatism: Malaysian evidence. *Asian Review of Accounting*, 20(1), 34–57. <https://doi.org/10.1108/13217341211224718>
- Mohd Saleh, N., Che Abdul Rahman, M.R., & Hassan, M.S. (2009). Ownership structure and intellectual performance in Malaysia. *Asian Academy of Management Journal of Accounting and Finance*, 5(1), 1–29.
- Muniandy, B., & Ali, M. J. (2012). Development of financial reporting environment in Malaysia. *Research in Accounting Regulation*, 24(2), 115–125. <https://doi.org/10.1016/j.racreg.2012.05.004>

- Pae, J., Thornton, D. B., & Welker, M. (2005). The link between earnings conservatism and the price-to-book ratio. *Contemporary Accounting Research*, 22(3), 693–717. <https://doi.org/10.1506/9FDN-N6ED-LJE9-A1HL>
- Pepinsky, T. B. (2008). Capital mobility and coalitional politics: Authoritarian regimes and economic adjustment in Southeast Asia world politics. *World Politics*, 60(3), 438–474.
- Piot, C., Janin, R. & Dumontier, P. (2011). IFRS consequences on accounting conservatism within Europe. CAAA Annual Conference 2011. Available at SSRN: <https://ssrn.com/abstract=1724635> or <http://dx.doi.org/10.2139/ssrn.1724635>
- Pope, P. F., & Walker, M. (2003). Ex-ante and ex-post accounting conservatism, asset recognition and asymmetric earnings timeliness. Retrieved from www.cass.city.ac.uk/_data/assets/word_doc/0011/40610/PopeandWalker1.docx
- PricewaterhouseCoopers. (2009). IFRS convergence in 2012: What does it mean for Malaysia? *PwC Alert, Issue No. 77*, April.
- Riahi-Belkoui, A. (2004). Politically-connected firms: Are they connected to earnings opacity. *Research in Accounting Regulation*, 17, 25–38. [https://doi.org/10.1016/S1052-0457\(04\)17002-1](https://doi.org/10.1016/S1052-0457(04)17002-1)
- Roychowdhury, S., & Watts, R. L. (2007). Asymmetric timeliness of earnings, market-to-book and conservatism in financial reporting. *Journal of Accounting and Economics*, 44(1-2), 2–31. <https://doi.org/10.1016/j.jacceco.2006.12.003>
- Schmalenbach, E. (1959). *Dynamic accounting* (G. W. Murphy & K. S. Most, Trans). London: Gee.
- Sillen, O., & Vasthagen, N. (1962). *Balansva`rderingsprinciper* [Balance sheet valuation principles] (7th ed.). Stockholm, Sweden: P. A. Norstedt & Soners Forlag.
- Sterling, R. R. (1967). Conservatism: The fundamental principle of valuation in traditional accounting. *ABACUS*, 3(2), 109–132. <https://doi.org/10.1111/j.1467-6281.1967.tb00375.x>
- Vichitsarawong, T., Eng, L. L., & Meek, G. K. (2010). The impact of the Asian financial crisis on conservatism and timeliness of earnings: Evidence from Hong Kong, Malaysia, Singapore, and Thailand. *Journal of International Financial Management and Accounting*, 21(1), 32–61. <https://doi.org/10.1111/j.1467-646X.2009.01035.x>
- Wan Ismail, W. A., Kamarudin, K. A., Van Zijl, T., & Dunstan, K. (2013). Earnings quality and the adoption of IFRS-based accounting standards: Evidence from an emerging market. *Asian Review of Accounting*, 21(1), 53–73. <https://doi.org/10.1108/13217341311316940>
- Watts, R. L. (2003a). Conservatism in accounting Part I: Explanations and implications. *Accounting Horizons*, 17(3), 207–221. <https://doi.org/10.2308/acch.2003.17.3.207>
- Watts, R. L. (2003b). Conservatism in accounting Part II: Evidence and research opportunities. *Accounting Horizons*, 17(4), 287–301. <https://doi.org/10.2308/acch.2003.17.4.287>
- Zéghal, D., Chtourou, S., & Sellami, Y. M. (2011). An analysis of the effect of mandatory adoption of IAS/IFRS on earnings management. *Journal of International Accounting, Auditing and Taxation*, 20(2), 61–72. <https://doi.org/10.1016/j.intaccudtax.2011.06.001>

APPENDIX

Differences of financial reporting standards IAS and IFRS

Financial Reporting Standards	IAS	IFRS
IAS 2	<p>Under IAS, inventories are required to be stated at a lower cost or market (LCM), with market defined as current replacement cost. Market should not exceed net realizable value (defined as the estimated selling price in the ordinary course of business less reasonably predictable costs of completion and disposal) or be less than NRV reduced by an allowance for a normal profit margin.</p>	<p>Under IFRS, inventories are stated at a lower cost or net realizable value (defined as the estimated selling price in the ordinary course of business less the estimated cost of completion and the estimated cost necessary to make the sale). Under IFRS, there is no concept of reducing NRV to allow for a normal profit margin.</p> <p>Unlike IAS, when the circumstances that previously caused inventories to be written down below cost no longer exist or when there is a clear evidence of an increase in net realizable value because of changed economic circumstances, the amount of the write-down is reversed so that the new carrying amount is the lower of the cost or the revised net realizable value (i.e. the reversal is limited to the amount of the original write-down). This occurs, for example, when an item of inventory that is carried at net realizable value because its selling price had declined, is still on hand in a subsequent period and its selling price has increased. Any impairment or reversal is recorded as a cost of sales in the period in which it occurs.</p>
IAS 17	<p>In the sale and leaseback transactions, Under IAS, a gain or loss on a sale-leaseback transaction is deferred and amortized over the lease term with limited exceptions regardless of the leaseback classification (seller retains less than substantial all of the use of the leased asset).</p>	<p>In the sale and leaseback transactions, under IFRS the timing of recognition of a gain or loss on a sale and leaseback transaction differs depending on the classification of the leaseback. A gain or loss on a finance lease is deferred and amortized over the lease term. A gain or loss on an operating lease is recorded immediately if the sale price is established at fair value. Otherwise, it should be deferred and amortized over the lease term.</p>

IAS 36	For fixed asset, impairment is calculated by comparing undiscounted cash flows to the carrying amount of the asset group. Therefore if undiscounted cash flow is lower than the carrying amount, then there is impairment being charged.	For fixed asset, impairment is charged by comparing the carrying amount with recoverable amount. Under IFRS impairment is assessed on the basis of recoverable amount, which is calculated as either fair value less costs to sell or value in use (discounted cash flows). If impairment is indicated, assets are written down to the higher recoverable amount.
--------	--	---

Therefore, impairment charges will likely occur sooner than under IAS. For example, assume a store's undiscounted cash flow exceeds the asset-carrying amount but value in use (i.e., based on discounted cash flows) is less than the asset-carrying amount. No impairment charge would be recorded under IAS but impairment would be recorded under IFRS.

IAS 36	An item of property, plant and equipment that qualifies for recognition, as an asset shall be measured at its cost. The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date.	Under IFRS, an entity may elect to value property, plant and equipment (PP&E) using either the cost or revaluation model. Under the revaluation model, an entire class of PP&E is revalued at fair value regularly. Revaluation increases are credited to equity. Revaluation losses are charged first against any revaluation surplus in equity related to the specific asset, and any excess charged to income.
--------	--	---

Estimates of useful life and residual value and the method of depreciation are reviewed at least annually.